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Chief Executive Officer

September 24, 2009

To: Supervisor Don Knabe, Chairman
Supervisor Gloria Molina
Supervisor Mark Ridley-Thomas
Supervisor Zev Yaroslavsky
Supervisor Michael D. Antonovich

From: William T Fujioka
Chief Executive Officer

RISK-ADJUSTMENT STUDY OF COUNTY MEDICAL PLANS

This is to provide you with the attached report entitled "Risk–Adjustment Study of Medical Plans." This report was prepared by our health insurance consultant, Mercer, at the request of the Chief Executive Office. It shows the relative disease burden within the County's various medical plans, and the extent to which the disease burden explains the differences in the costs of the plans.

The need for this analysis was triggered by concern over the rising costs of the Kaiser Health Plan, the County's most expensive HMO. It was also triggered by claims from Kaiser that its costs are attributable to a membership base that is sicker, on average, than the populations covered by the County's other medical plans. Kaiser asserts that their sicker population requires a higher level of expenditure on medically necessary services.

What the Study Found

The study used a widely accepted actuarial technique that is based on a combination of age and gender comparisons and prescription drug usage. By looking at the types and quantities of drugs used by a particular group, it is possible to measure the current level of morbidity within that group, and to predict that morbidity for up to one year in advance. The study measured actual morbidity for the 2005-2007 period, and projected morbidity for 2008.

Key findings include the following:

- **Kaiser covers a relatively sick population:** Kaiser's assertions in this regard have been correct. Kaiser covers a population that is, on average, 20% sicker than the populations in the other County sponsored HMOs. The difference is persistent over the period of the study, and the trend appears to be getting worse.

- **Morbidity explains costs:** The study actuarially adjusts the premiums for the various medical plans to neutralize the effects of disease burden. When these adjustments are made, Kaiser is no longer the most expensive HMO. In fact, it becomes the lowest cost HMO in most instances.

- **Union sponsored plans have the lowest morbidity:** The County approved union sponsored medical plans include the ALADS Plans, the Fire Fighters Local 1014 Plan, and the CAPE Plans. The populations covered by these plans are, on average, 10% healthier than the populations in the County sponsored plans.

Two additional points should be noted. First, the union sponsored plans did not provide drug usage information for this study. Consequently, Mercer evaluated these plans by using age and gender information, exclusively. This information is readily available within the County's payroll and benefit administration systems.

Also, a similar study was previously completed by Mercer for years 2003 and 2004 with projections for 2005. The prior study similarly found that Kaiser has relatively high rate of morbidity within its County employee population. The two studies, together, show a clear pattern.

Why the High Morbidity in Kaiser?

A high disease burden can be the result of too many sick people within a given population, or too few healthy people. Either situation creates a high concentration of high risk individuals relative to the size of the group. In Kaiser's case, we believe the problem is a lack of healthy people. The healthier employees are simply not enrolling in Kaiser at the rates they have in the past. This, no doubt, is the result of the high cost of Kaiser and the fact that lower cost coverage is readily available through the County's cafeteria benefit plans.

Over the past ten years, Kaiser's membership has dropped from approximately 64% of the eligible County population to approximately 49%. That fact combined with a disease

burden that is high, and trending even higher, is conclusive evidence that the employees leaving the program are the healthier employees. Moreover, it is only reasonable to conclude that the relatively healthy "low users" of medical services would be the least willing to pay more than is necessary for the coverage they are seeking. In the case of represented employees, lower cost coverage is available from CIGNA, PacifiCare, and the union sponsored plans.

It should also be noted that the tendency for medical plan price to steer employees into one plan versus another is especially acute under the County's cafeteria benefit environment. Under all of the cafeteria plans, including the Choices and Options Plans, money not spent on medical plan premiums is returned to the employee in the form of income. In 2009, for example, a family subscriber represented by the Coalition who chooses Kaiser over the CIGNA HMO pays $3,251 per year more for that decision. This money converts to additional take-home pay if the individual changes to CIGNA.

Kaiser's problem is a kind of Catch 22. The healthy population it needs cannot re-establish itself within the plan in sufficient magnitude until the price of the coverage comes down, but the price cannot come down until the healthy population is already there. Unfortunately, there is no reason to believe this situation will self-correct, or that it will not get worse over time. Absent some form of intervention, we must assume that the Kaiser population will continue to deteriorate, and that the plan will eventually become inviable.

If Kaiser were no longer an option for County employees, all of the risk in the plan, good and bad, would become the risk of the other County medical plans. Therefore, the issue is not how to escape this risk, but how to manage it. This makes this issue bigger than Kaiser, or any one medical plan.

Next Steps

The Kaiser problem is a long-term problem that will require a long-term solution. It may also require some new thinking on how we determine employee costs for medical insurance under our cafeteria benefit plans. We may need to place more emphasis on pricing these benefits in a way that creates a more even spread of risk over the various medical plans. Arguably, employees should pay a price that reflects the value of the plan they choose if the risk were spread properly – even if it is not. Plans with similar benefits should have a similar cost to employees, disease burden notwithstanding.

This issue is further complicated by the fact that some of the County's medical plans are actually benefiting from this problem – at least for now. They are getting the good

health risks that Kaiser is not getting. This would include the union sponsored health plans which, as noted above, cover groups that are roughly 10% healthier than other County employees. Therefore, any solution that is brought to bear will have implications for the County's other medical plans. Nevertheless, we intend to fully explore all of the potential long-term solutions with our employee representatives and our insurers.

Response to Prior Board Direction on This Issue

Health insurance costs and Kaiser costs, in particular, have been the subject of considerable Board attention in the past. On September 11, 2007, the Board directed the Chief Executive Office to (1) determine the feasibility of forming a consortium of other public agencies to address problems regarding data disclosure by health insurance carriers; (2) pursue legislative approaches to require better disclosure of data, and (3) examine opportunities to implement innovative cost saving initiatives beyond those in the fringe benefit agreements with the County's Unions. In a September 8, 2008 status report, we indicated that it was premature to form a state-wide consortium on data disclosure or pursue legislative alternatives aimed at data disclosure pending the outcome of the Mercer risk study.

We believe that the Mercer risk study effectively resolves the first two directives issued in 2007. We now are in a much better position to understand the reasons for the differences in cost between Kaiser and the other medical plans. We now know that disease burden is the problem, not data disclosure. However, with regard to data disclosure, Mercer has reported that Kaiser's capturing and reporting of data has improved significantly over the past two years. For the current 2009 premium rates and the proposed 2010 premium rates, Mercer has reported Kaiser's rates as justified.

With regard to the third directive in the above Board order, we are also pursuing wellness and other cost savings initiatives with our employee representatives. One of the products of this effort was implemented on January 1, 2009 when we recommended, and the Board approved, a waiver of office co-pays for various preventive health care services. We expect to make more wellness related recommendations in the future. The work in this area will probably never stop.

Mercer's report was shared in draft form with the various insurers for the County sponsored plans and with the Coalition and Local 721 and their consultants. The attached final report includes a summary of the responses from the various stakeholders, including a complete copy of the responses from the union consultants. There are a variety of observations and opinions included in these responses, but no one found any technical defect with the study.

Please call me if you have any questions or your staff may contact Wayne Willard at (213) 974-2494, or at wwillard@ceo.lacounty.gov.

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WGL:WW:df

Attachment

c: Executive Office, Board of Supervisors
Auditor-Controller
County Counsel
Department of Human Resources
SEIU Local 721
Coalition of County Unions
CIGNA
Kaiser
Anthem Blue Cross
PacifiCare
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